

Central Intelligence Agency



Washington, D. C. 20505

Directorate of Intelligence

18 June 1984

Latin America: The Cartagena Debt Conference [redacted]

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Summary

Latin American foreign and finance ministers will meet this week in Cartagena, Colombia at a specially-called conference to discuss the debt and trade problems facing the region. [redacted]

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[redacted] the Presidents of Brazil, Mexico, Argentina, and Venezuela--key decisionmakers on the debt issue--do not advocate a formal debtors' cartel, and recognize that such action would only jeopardize future access to funds and current financial negotiations. Instead, these countries probably will join as a group to press industrial countries for concrete measures to ease the repayment burden. [redacted]

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Even if collective action does not materialize, however, we believe there is growing potential for smaller debtors to shake the financial rescue programs. Bolivia's recent unilateral payments suspension, motivated by the need to stave off labor

This memorandum was prepared by [redacted] of the South America Research Branch, Office of African and Latin American Analysis. This analysis is based on information as of 14 June 1984. It was coordinated with the Office of Global Issues. Comments and questions may be directed to the Chief, South America Division, ALA, [redacted]

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unrest, could serve as a precedent for other Andean debtors. We speculate that debtors' defiance may grow--with the tacit support of the larger borrowers--and directly impact ongoing debt reschedulings and discussions with the IMF. [REDACTED]

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Such a rebellion would increase pressure on private bankers to ease repayment terms to facilitate debtors' economic recovery. It also would heighten political pressure, mainly on Washington, for longer repayment schedules, extended grace periods, interest rate concessions, a ceiling on debt servicing determined by the level of export earnings, easier IMF adjustment programs, and easier access to industrial country markets. [REDACTED]

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The Cartagena Conference

In response to a call by Argentine President Alfonsin, Latin foreign and finance ministers will meet on 21-22 June in Cartagena, Colombia. Although we do not yet have a complete list of countries attending, we expect high level representation from the seven signatories of the Latin American chiefs of state letter to the London Summit, plus Chile, Bolivia, and the Dominican Republic. From the Latin point of view, this conference will be an opportunity to examine strategies and exert some political pressure to alleviate their financial burden.

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[REDACTED] the conference is aimed at fostering constructive dialogue with creditor governments. [REDACTED]

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* The signatories included Argentina, Brazil, Colombia, Ecuador, Mexico, Peru, and Venezuela. [REDACTED]

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Major Debtor Positions.

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[redacted] **Argentine** cabinet officials (both political and economic) are advising President Alfonsin to advocate a tough policy with bankers at the proposed meeting. Alfonsin has stated, [redacted] that he will not join a debtors' cartel, and US Embassy and press sources indicate this sentiment is shared by influential advisers. He is proposing easier conditions from the IMF--as indicated in the program recently presented to the Fund--and better renegotiation terms from bankers. Foreign Minister Caputo, who probably will attend, sees the meeting primarily as an opportunity to press creditors for more time and flexibility, [redacted]

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[redacted] Finance Minister Grinspun, another likely delegate, hopes this will be an opportunity to propose limits on foreign interest payments each country must make on its foreign debt to a percentage of that country's exports, [redacted]

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Brazil's acting foreign minister recently told US officials that support for the conclave reflects growing criticism of rising interest rates, but Brasilia would not join a debtors' cartel. The Brazilians believe that the success of their adjustment policies will enable them to obtain more generous concessions from bankers in upcoming financial negotiations. Finance Minister Galveas, who has done some preliminary drafting of the declaration, told US Embassy officials in late May that a future declaration would emphasize alarm about rising interest rates as a threat to stabilization programs, but would not support a debtors' club. [redacted]

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[redacted] Central Bank President Pastore recently indicated Brazil would not negotiate its debt problems on any joint basis, [redacted]

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Mexico's President de la Madrid has played down radical approaches to the debt crisis in favor of seeking constructive solutions, according to the US Embassy. [redacted]

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[REDACTED]

Venezuelan President Lusinchi reportedly has been advised by former President Carlos Andres Perez and many ruling party leaders to call for a debtors' club, [REDACTED] US Embassy, press, [REDACTED] indicate that he has rejected this option. Finance Minister Azpurua says Venezuela is not willing to participate in a debtors' club, but sees a common interest in concern over interest rates, according to the US Embassy. He supports debt renegotiations on a country-by-country basis because the Venezuelans do not believe an IMF-adjustment program should be required for countries only desiring to reschedule past due debts. [REDACTED]

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The Smaller Debtors. Colombia's President Betancur has publicly said that the foreign debt problem can be solved if there is political willingness to do so. He favors IMF adjustment programs that do not undermine political and social stability. He also advocates ceilings on interest rates, conversion of short-term debt into medium-term fixed interest bonds, and more lending by multilateral credit institutions to ease the burden of adjustment. [REDACTED]

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Most smaller Latin debtors--**Bolivia, Chile, Dominican Republic, Ecuador, Peru**--support the debt meeting, and some may push for more radical solutions. **Bolivian** Foreign Minister Fernandez says La Paz supports a joint declaration against interest rate increases. **Chile** will not play an active role, according to Finance Minister Escobar. The US Embassy indicates, however, that there is strong support within some government [REDACTED]

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economic and political circles in Santiago, including President Pinochet, for joint action with other Latin debtor countries to improve repayment terms. [REDACTED]

Ecuadorean President Hurtado is urging [REDACTED]

[REDACTED] collective measures in debt negotiations in response to rising interest rates. The Embassy recently reports, however, that the government will strike a moderate stance at Cartagena but will seek concrete solutions to debt problems. Similarly, the US Embassy in **Santo Domingo** indicates government support for a consolidated front in negotiations with creditors. **Peruvian** President Belaunde has voiced support for the conference; former Prime Minister Ulloa has publicly said that Peru will press for lower interest rates. [REDACTED]

A Formal Cartel Unlikely

Western bankers are apprehensive about the potential for joint action to force easier debt repayment terms, but we believe the evidence is conclusive that Mexico, Brazil, and Venezuela would not now join a debtors' club to confront creditors. [REDACTED]

[REDACTED] these governments, motivated by self-interest, recognize that joint action would only jeopardize their future access to world money markets. We judge that participation by the larger debtors would be crucial to the creation of any cartel because they hold some 60 percent of the \$350 billion of outstanding Latin external debt. Consequently, we believe there is only a slight chance the Cartagena conference will result in any major near-term changes in the current financial rescue programs. [REDACTED]

In part, this assessment is based on evidence of discord developing among the debtors. [REDACTED]

[REDACTED] there will be problems in coordinating a common position at Cartagena because there are varying points of view between the foreign and finance ministers in individual countries and among finance ministers regionwide. [REDACTED]

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[REDACTED]

The meeting, however, may end on a "seemingly united front" with Latin American political leaders--spurred on by the Argentines--emphasizing the need for a political solution. They will probably issue a joint conference communique criticizing growing protectionism and dissatisfaction about rising interest rates undermining their stabilization programs. They will probably also call for more flexible IMF conditions and increased lending by the World Bank to offset adverse external shocks. In addition, we believe they will propose concrete measures to ease the repayment burden similar to those being requested by Mexico.

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Mexico will soon request multiyear loan rescheduling, lower interest rate spreads, concessions, and renegotiation of past agreements. Although banking opinion is mixed, the Mexicans are probably hoping to capitalize on growing sentiment in financial circles that debtors who have made economic sacrifices should receive preferential treatment.

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[REDACTED] Proposals such as caps on interest rates and interest capitalization schemes will also be more appealing to the debtors.

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The greatest risk at Cartagena is that Latin American debtors will find a way to patch over differences not by actions but by words. Because there is likely to be little agreement on operational matters the more moderate governments could seek to placate the radical ones by accepting more aggressive rhetorical criticism of the creditors. While the major debtors will be able to separate the polemics from the reality of the debt situation, calls for action could encourage small debtors to think about striking out on their own.

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Beyond Cartagena

We speculate that the smaller debtors have a growing potential to undermine creditors' continued cooperation in making new loans and rescheduling debts. This judgment is based in part on reactions to Bolivia's unilateral suspension of payments in late May. Although the actual repayment amounts are small, bankers fear that this event could set a dangerous precedent against time-honored lending rules and financial adjustment strategies. Such a spontaneous, unilateral action could set in motion a chain reaction among other small debtors, in our judgement. Taken together, these actions have the potential to cause major difficulties for the financial rescue programs as now constituted. [redacted]

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[redacted] the potential support La Paz's recent unilateral moratorium could draw from other Latin debtors. Argentine Economy Minister Grinspun, for example, has publicly called the Bolivian move a "sovereign decision". Press reports also indicate Peruvian President Belaunde expressed his "solidarity" with Bolivia, and Alan Garcia, presidential candidate for Peru's APRA party in the 1985 elections, has said that if elected he would follow in Bolivia's footsteps. The advisory committee reports sending a team to convince La Paz to continue payments in return for debt reschedulings, a move we believe may be seen as caving in under pressure. [redacted]

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From the standpoint of the major debtors, they can thwart a cartel but have little leverage to head off unilateral payments suspensions. We speculate they may tacitly support such moves in hopes of benefiting from any concessions granted by creditors to the smaller debtors. Any easing of commercial repayment terms, for example, would probably cause Brasilia and Buenos Aires to strengthen their determination to obtain a multiyear restructuring package on easier terms from commercial creditors. [redacted]

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The Potential Rebels

We believe that **Colombia**, **Peru**, and **Ecuador** would be the most likely candidates to declare unilateral payments moratoriums in coming months. We concur with a recent US Embassy report that **Colombia** is near a financial crisis because its liquid foreign exchange reserves, the Embassy reports, are now equal to about one month import cover. Bogota is still resisting bankers' advice to turn to the IMF soon to obtain foreign financial support because it fears the political consequences. We judge that President Betancur--a populist politician who advocates easier repayment terms--may be tempted to suspend payments abruptly to solicit concessions from bankers. [REDACTED]

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Although the US Embassy reports that **Peru** met first-quarter IMF performance criteria, we believe the Belaunde administration will have severe difficulties remaining in compliance with its standby agreement this year in the face of mounting social unrest and presidential election campaign spending pressures. The relaxation of price controls and higher import surtaxes will probably cause inflation to accelerate beyond last year's 111-percent rate, further eroding living standards and raising social tensions. On 9 June, the Peruvian government imposed a 30-day state of emergency to cope with social unrest caused by workers demanding wage increases to compensate for the rising living costs. Should Lima implement growth-oriented policies, its relations with the IMF would deteriorate, risking a cutoff of commercial bank financing and other foreign financial assistance. [REDACTED] President Belaunde has periodically considered adopting hardline tactics with bankers to ease the adjustment burden. We judge that he might now consider such measures in view of growing domestic political and labor pressures and Bolivia's action. [REDACTED]

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Ecuador's conservative President-elect Febres Cordero has publicly indicated that he will pursue better debt renegotiation terms than obtained by his predecessor. Despite compliance with the IMF, bankers have refused to provide new money and refinancing of 1984 debts, forcing Ecuador to accumulate arrears above last year's unprecedented level. We speculate that Febres

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Cordero could suspend debt servicing and push for concessions from bankers, in part to improve his standing with labor and the left. [REDACTED]

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Likely Manifestation of Rebellion

We believe the smaller debtors--acting individually but moving in the same direction--will seek major concessions on a range of fronts to ease their financial burdens. Spurred by Argentina's recent example, we believe these countries would present more economically and politically palatable programs to the IMF on a "take-it or leave-it" basis. We also believe that these debtors will demand new loans from bankers at fixed interest rates and with repayment periods in excess of 15 years. The more rebellious debtors would probably also demand lenders capitalize interest payments or place a cap on interest to insulate them from increases in world interest rates. [REDACTED]

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Prospects and Implications for the United States

We believe that debt management questions are ceasing to be strictly technical economic issues. Instead, Latin American leaders will soon begin pressing the industrial countries, in our view, to take a more active role in easing the repayment burden. They will probably claim that continued economic austerity has the potential to undermine their governments by sparking labor unrest and popular demonstrations while eroding middle-class support. The debtors probably will advocate that creditor governments, for example, relax regulatory constraints to debt relief proposals. We also believe these debtors will begin seeking official intercession with the IMF to ease austerity measures. [REDACTED]

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The danger debtors recognize--and the factor that is most likely to restrain their inclination to politicize the debt issue--is that any actions beyond hardball but businesslike negotiations would reduce the willingness of commercial banks to extend new credits and continue restructurings. Bankers will continue to be cool to the idea of an interest rate cap because it might force them to lend at a loss. Any relaxation of IMF

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conditions would further unsettle bankers, who believe economic adjustments are essential for the debtors to return to a solid financial footing. [REDACTED]

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Schemes like the multiyear restructuring package for Mexico demonstrate new flexibility on the part of commercial bankers toward those debtors who have made economic adjustments, but they fail to address the problem of higher interest costs for which Washington will take the heat. Banker reluctance to lower interest rates to levels sought by some debtors is likely to put increased pressure on creditor countries--particularly the United States--to find some solution. [REDACTED]

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Refusal by US regional and European banks to participate in new loan packages for troubled Latin debtors is placing an increased burden on the larger US banks to sustain rescue operations. With the financial community already concerned about high loan exposures, a succession of unilateral moratoriums would quickly push many loans into the nonperforming category. At worst, this could require a US government bailout of large banks to prevent financial panic. [REDACTED]

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In the absence of trade liberalization in industrial countries, we speculate that the Latin debtors could use existing tools that were designed for conserving scarce foreign exchange in an attempt to make political points. Hemispheric counter-trade agreements, bilateral credit lines, and barter trade could be used to restrict US exports and in the process generate political pressure for more lenient treatment of debtors. The 1983 agreement between Brazil and Mexico, which included \$3 billion in barter, Brazil's efforts to reach similar agreements with other Latin American countries, and new Colombian and Ecuadoran laws allowing increased barter trade underscore the potential impact such a tack could have if used aggressively. Any decision to try the trade option would, of course, have to weigh the economic costs to the debtors--higher import costs and lower potential growth. Even so some debtors could be willing to pay the costs, or more likely point to deals that already are in place, because of financing constraint, as an example of their resolve. [REDACTED]

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Attendance at Latin American Debt Conference
in Cartagena, Colombia, 21-22 June 1984

<u>Country</u>	<u>Delegation</u>
Argentina	Foreign Minister Dante Caputo Economy Minister Bernardo Grinspun
Bolivia	Foreign Minister Gustavo Fernandez Finance Minister Oscar Bonifaz
Brazil	Foreign Minister Ramiro Saraiva Guerrero Finance Minister Ernane Galveas
Chile	Foreign Minister Jaime del Valle Economy Minister Modesto Collados
Colombia	Foreign Minister Rodrigo Lloreda Finance Minister Edgar Gutierrez
Dominican Republic	Foreign Relations Secretary Augusto Vega Finance Secretary Jose Santos
Ecuador	Foreign Minister Luis Valencia Finance Minister Pedro Pinto
Mexico	Foreign Secretary Bernardo Sepulveda Finance Secretary Jesus Silva Herzog
Peru	Prime (and Foreign) Minister Sandro Mariategui Economy Minister Jose Benavides
Venezuela	Foreign Minister Isidro Morales Minister and Advisor to the Presidency for International Economic Affairs Manuel Perez Guerrero Finance Minister Manuel Azpurua